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DEPARTMENT OF STATE

Washington, D.C. 20520

March 26, 1982

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RF:WEBMEMORANDUM FOR MR. WILLIAM P. CLARK  
THE WHITE HOUSE

Subject: Energy Security at the Versailles Economic Summit

The United States is not receiving sufficient credit for the beneficial impact of our energy security policies. Over the past few months the U.S. Government has been criticized for taking a relatively negative stance in international fora against pre-planned mechanisms like sub-crisis management. Due to budget cutbacks at home, we have had to reduce our funding of multilateral energy research projects. In addition, our objections to the Siberian pipeline have been met with strong European resistance. This has led some to question U.S. sincerity and commitment towards international energy cooperation.

Yet, the facts show that our policies of removing market impediments to promote fuller energy development have resulted in significant improvement in the energy area. There has been a dramatic reduction in U.S. oil imports which has brought about a better oil market situation benefiting all nations. While other countries have lagged behind in building oil stocks, the U.S. has used the present market situation to its advantage and doubled the Strategic Petroleum Reserve in less than a year. Our coal industry is rushing to meet not only U.S. coal demand but also that of our Allies. The President has made one of the strongest supportive statements for nuclear power of any Head of State in recent times. These developments represent a positive approach to international energy policy making.

The upcoming IEA Ministerial (May 24) and Versailles Economic Summit (June 4-6) offer us the opportunity to stress the positive aspects of U.S. energy policy, to renew our leadership role based on the principles of letting the market do its job and to show the need to strengthen cooperation on energy security. The attached paper suggests how this objective can be achieved. It is proposed that the paper be provided to the Personal Representative of the EC who has been assigned the responsibility of preparing a paper on energy for the Versailles Economic Summit.

The paper has been reviewed and commented on by DOD, Treasury, DOE, CIA, NSC, CEA, OMB and OPD.

L. Paul Bremer, III  
Executive Secretary

Attachment

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## Energy Security at the Versailles Summit

### Summary

While energy today is not the front page news issue which it was at the Tokyo (1979) and Venice Summits (1980) it still remains a vital element of overall economic performance in Summit countries. Indeed, instead of a constraint on economic development, as we have viewed it in the past, energy may be a factor contributing to recovery. Lower prices for energy bring long awaited relief from inflation and pressure for higher wages and business costs. Economic recovery in turn will bring new opportunities for greater energy investment.

Without confusing optimism with complacency, the time is right to reconsider international energy imperatives in a more positive vein. There are abundant and economically attractive energy resources within the Western community. Developing these resources will allow revenues to stay at home, reduce inflation and bring new employment and economic opportunities. What is needed at the Versailles Summit is a renewal of commitment to develop indigenous energy resources through greater reliance on market forces supplemented by government action when broader Western economic and security concerns are threatened.

Energy security involves both reliance on market forces and a prudent concern for political and strategic factors. The basis of energy security cooperation among the industrialized countries rests on a network of political, economic and strategic commonalities and values that tie the industrialized democracies together and give them a collective strength that is greater than the sum of each individually. A threat to the energy security of one is a threat to them all. In recognition of this fact, the major industrialized democracies have jointly endeavored to develop means within the International Energy Agency and European Community to minimize at acceptable cost the disruptive effects of energy shortfalls when they threaten the common interest of all. The Versailles Economic Summit can renew and strengthen this resolve and provide the foundation for a more economically efficient and more secure energy future.

Energy security objectives at Versailles should be threefold:

- (i) to underscore the importance and effectiveness of primary reliance on market forces in encouraging development of energy supplies and more efficient use;

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- (ii) to encourage Summit countries to fully develop on an economical basis the rich resource base of the community of Western countries, thereby reducing dependence on insecure sources of supply; and
- (iii) to continue efforts to minimize at acceptable costs the disruptive effects of oil and gas shortfalls and/or cutoffs from less reliable exporters.

## I. Reliance on Market Forces

Experience has shown us that permitting greater opportunities for operation of market principles is the most effective means to achieve structural adjustment of energy economies. The price increases of the last few years have significantly reduced consumption for energy and, in particular, oil. This illustrates most convincingly the importance of clear market signals to consumers. Likewise, production of indigenous oil, gas and coal has been stimulated where market forces have been allowed to function properly. Exploration activities for oil and deep gas are at an all time high in the United States. Energy prices have historically been high in European economies due in part to higher taxes resulting in lower per capita energy use than in North America, where prices have been relatively lower.

Examples abound as to the importance of the market, yet there are still a number of cases in Summit countries where market impediments are evident: Canadian domestic oil prices remain below international levels; British monopolistic practices keep U.K. gas producer prices at relatively low levels (although this policy may soon change in an effort to stimulate greater exploration and production); the United States continues to regulate natural gas prices; Germany maintains a system of coal import quotas; and in Italy, France and Japan government control slows the response of domestic oil markets to international developments. All of these conditions exist due to specific and perhaps understandable political factors and they will be difficult to change. Nevertheless, Summit countries should commit themselves to remove market impediments and to allow domestic energy prices to reflect international levels. In areas lacking a competitive world pricing standard, such as electricity generation, the marginal economic costs could serve as a guideline for pricing strategies.

## II. Accelerate Energy Alternatives in Western Countries and Endorse Freer Western Energy Trade and Investment

Western countries as a whole are well endowed with energy resources. The best means for achieving long term energy security is to develop these resources in an economical

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manner to their fullest potential and to encourage freer trade and investment in resources among Western countries. The aim should be to reduce the percentage of energy resources coming from potentially unreliable country sources.

(i) Coal is the most abundant resource within the West. Suppliers such as Australia, Canada and the United States are in a position to meet their own growing requirements and the import needs of Western Europe and Japan. Recent figures illustrate that the private sector is making significant progress in the development and shipping of U.S. coal, including increasing port capacity. Coal importing nations should be further encouraged to invest in mines and ports in coal producing countries, thereby enabling all countries to share in the costs and benefits of this key resource. European nations and Japan can facilitate coal trade by promoting construction of receiving terminals and adopting measures to increase coal use in industry and electrical generation. Producers and consumers should reaffirm the need for economically viable long term contracts that will enable sufficient private investment to promote greatly expanded coal production, use and trade.

(ii) Recent large natural gas discoveries in the U.S. (lower 48 and Alaska), Canada, Norway and the U.K. suggest that this convenient and widely accepted fuel exists in abundance within the Western community. We should be able to agree on the desirability of minimizing dependence on gas from the Soviet Union, replacing it where economically feasible from Western and reliable developing country sources. Development and transport of OECD gas reserves will not only provide a source of certain and predictable supply for years to come, but also stimulate economic opportunity and create jobs within industrialized countries.

(iii) Nuclear programs are proceeding relatively well in most Summit countries, although some nations -- notably the United States -- are lagging behind. A strong statement of support by Heads of State can help sustain the momentum of worldwide nuclear energy growth and renew confidence in those countries where programs are delayed. A commitment to strive for pricing electricity at the marginal economic cost could help spur investment. The Summit might mandate the High Level Monitoring Group to devote special attention to nuclear energy over the next year to assess the state of nuclear development and key problems (financial, burdensome regulatory practices, safety, and back-end of the fuel cycle). Heads of State should also consider asking the Nuclear Energy Agency in coordination with the International Energy Agency to assess the feasibility of a joint international waste management project.

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(iv) Some potentially promising long term high risk energy technologies have too distant a pay back period to interest private investors. In addition, investment in research and development of sources like fusion tend to be very expensive and too extreme a burden on individual country budgets. Summit countries could consider strengthening their cooperation by reviewing their national efforts to identify opportunities for sharing expenses and expertise to expedite the development of these technologies. This could be done perhaps as part of the French (host country) focus at this Summit on new technologies.

(v) Developing countries could provide a significant part of the world's marginal energy production over the coming years. Summit countries should consider measures which would increase private investment in developing country energy production through such means as an improvement in LDC investment climate and an increased multiplier effect of World Bank lending.

### III. Preparing for Disruptions in Short Term Energy Supplies

Despite a welcome respite from oil market turbulence, the chance of sudden and potentially major disruptions in oil supply still exists. By reducing its imports from unreliable suppliers the U.S. has reduced its vulnerability to oil supply disruptions, but Europe and Japan remain highly dependent on uncertain sources of supply. All Western countries would suffer from the economic and political consequences of a new supply interruption.

In addition, a dangerous blind spot has emerged with respect to the security implications of alternative sources of energy, some of which represent risks equal to that of insecure sources of oil supply (i.e., European dependence on Soviet gas). Thus, Summit countries may wish to address a number of these emergency preparedness problems.

(i) Large scale oil disruptions. The IEA and EC emergency sharing systems remain the principal intergovernmental mechanisms for sharing the burden of major shortfalls in oil supply. Summit countries should reaffirm their support of these systems, recognizing that individual methods of complying with the international sharing schemes should be left to the discretion of each country.

(ii) Smaller oil disruptions. Considerable effort has recently been expended to identify possible responses in the event of a 1979 type market syndrome: a relatively small shortfall resulting in a disproportionate price rise. Because it is not possible to describe accurately remedies for emergencies of an unknown character, the U.S. has encouraged all IEA countries to increase oil stocks. Higher

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levels of stocks will buy time in the event of a disruption in order to meet at high governmental level and to decide what action, if any, is warranted by the circumstances. The mere existence of these stocks should have a very positive effect in times of crisis. This focus on supply side measures would constitute a salutary corrective to the preoccupation with price and allocation schemes which distort market forces. In the spirit of this premise, the U.S. has more than doubled its Strategic Oil Reserve within the last year; some other countries have increased reserves, but a number have unfortunately lagged behind.

The IEA and EC should continue to carefully monitor individual country stock positions and assess whether they are adequate in light of current oil market conditions. We might also usefully continue discussions within the IEA/EC on how individual countries would use stocks in times of oil market disturbances. Such discussions are likely to conclude that stock sharing schemes in a sub-crisis situation are not workable, nor desirable. This will act as an inducement for each country to build stocks for its own use.

(iii) Natural Gas Security. Given the projected increased role of natural gas imports to Western Europe and Japan, Summit countries should develop with utmost urgency means for achieving enhanced gas security, including increased storage facilities, surge capacity in the OECD area to be tapped in times of emergency, better integration of the European gas grid and more dual-fired capacity among large industrial users. The IEA and EC should continue to coordinate these efforts so that an inter-governmental approach can be taken to complement national efforts.

#### IV. Draft Energy Security Statement

The following text illustrates the type of agreement which might be reached by Summit countries to emphasize the points made in this paper.

##### Heads of State:

-- agreed that investment in Western energy resources can accelerate economic recovery and provide for a stable long term energy future;

-- underscored the importance of market principles in encouraging development of energy supplies and more efficient energy use;

-- encouraged Summit countries to develop fully the large and economically attractive energy resource base of Western countries, thereby reducing dependence on insecure sources of supply;

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-- noted that free trade of energy resources within the West should be encouraged; and

-- recognized that the world economic system remains susceptible to sudden energy supply disruptions.

To realize expeditious development of Western energy resources and free trade and investment they might agree to:

-- commit themselves to the goal of removing market impediments, eliminating obstacles to energy investment and allowing domestic energy prices to reflect international levels. In areas lacking a competitive bidding pricing standard, such as electricity generation, the marginal economic costs should serve as a guideline for pricing strategies;

-- continue efforts to expand Summit country coal production, use and trade by encouraging viable long term contracts to stimulate private investment. Coal producing countries will welcome investment in mines and ports, thereby enabling all countries to share in the costs and benefits of this key resource;

-- expand Western natural gas production and trade, thereby minimizing dependence on insecure sources of supply and providing economic opportunities within the West;

-- continue efforts to expand nuclear energy worldwide and call upon the Nuclear Energy Agency in concert with the International Energy Agency to assess the feasibility of a joint international waste management project;

-- review national R and D programs, especially those involving significant funding to see how sharing of costs and expertise might expedite the research; and

-- consider measures which would increase private investment in developing country energy production through such means as an improvement in LDC investment climate and an increased multiplier effect of World Bank lending.

Recognizing that the energy market remains inherently risky, Summit countries also:

-- reaffirmed their commitment to the OEA oil emergency sharing system;

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-- agreed that the present troubled market situation provides an opportunity to build strategic oil stocks and recognized the usefulness of continued discussions on how individual country stocks might be used in time of oil market disturbances; and

-- encouraged the IEA and EC to continue their efforts to coordinate Member Country efforts to enhance Western natural gas security.

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Clearances:

E: RHormats <sup>LFA</sup>

EB/IEP: AWendt

OES/NTC: MProchnik

E: MCasse

EUR/RPE: AReichenback (subs)

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